

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Ruth Y. Goldway, Chairman;
Mark Acton, Vice Chairman; and
Robert G. Taub

Competitive Product Prices
Priority Mail Express
Priority Mail Express Contract 18

Docket No. MC2014-25

Competitive Product Prices
Priority Mail Express Contract 18 (MC2014-25)
Negotiated Service Agreement

Docket No. CP2014-48

ORDER ADDING PRIORITY MAIL EXPRESS CONTRACT 18
TO THE COMPETITIVE PRODUCT LIST

(Issued May 1, 2014)

I. INTRODUCTION

The Postal Service seeks to add a new product identified as Priority Mail Express Contract 18 to the competitive product list.¹ For the reasons discussed below, the Commission approves the Request.

¹ Request of the United States Postal Service to Add Priority Mail Express Contract 18 to Competitive Product List and Notice of Filing (Under Seal) of Unredacted Governors' Decision, Contract, and Supporting Data, April 18, 2014 (Request).

II. BACKGROUND

On April 18, 2014, in accordance with 39 U.S.C. § 3642 and 39 C.F.R. § 3020.30 *et seq.*, the Postal Service filed the Request, along with supporting documents. In the Request, the Postal Service asserts that Priority Mail Express Contract 18 is a competitive product that establishes rates “not of general applicability” within the meaning of 39 U.S.C. § 3632(b)(3). Request at 1. Among the supporting documents, the Postal Service included a copy of the Governors’ Decision authorizing the product, a contract related to the proposed new product, requested changes to the competitive product list, a statement supporting the Request, and a certification of compliance with 39 U.S.C. § 3633(a). *Id.* Attachments A through E. In addition, the Postal Service submitted an application for non-public treatment of materials requesting that redacted portions of the Governors’ Decision and the contract, customer-identifying information, and related financial information remain under seal. *Id.* Attachment F.²

The contract is intended to take effect one business day following the day on which the Commission issues all necessary regulatory approvals. Request, Attachment B at 2. It is set to expire three years from the effective date. *Id.*

On April 21, 2014, the Commission issued an order establishing the two dockets, appointing a Public Representative, and providing interested persons with an opportunity to comment.³

² In its application for non-public treatment of materials, the Postal Service asks the Commission to protect customer-identifying information from public disclosure indefinitely. *Id.* at 7. The Commission has consistently denied similar requests for indefinite protection. See, e.g., Docket Nos. MC2011-1 and CP2011-2, Order No. 563, Order Approving Express Mail Contract 9 Negotiated Service Agreement, October 20, 2010, at 6-7.

³ Order No. 2060, Notice and Order Concerning the Addition of Priority Mail Express Contract 18 to the Competitive Product List, April 21, 2014.

III. COMMENTS

The Public Representative filed comments on April 28, 2014.⁴ No other interested person filed comments. She states that Priority Mail Express Contract 18 appears to benefit the Postal Service, the contract partner, and the general public. *Id.* at 1. She observes that the Request appears to comport with the provisions of 39 U.S.C. §§ 3632 and 3633 as well as 39 C.F.R. § 3015.5. *Id.* She asserts that based on the financial workpapers, Priority Mail Express Contract 18 will likely meet the requirements of 39 U.S.C. § 3633(a) during its first year. *Id.* at 2. She notes that in subsequent years, the contract provides a mechanism for updating customized prices. *Id.* Based on the Postal Service's financial model, she concludes that the negotiated prices should generate sufficient revenues to cover costs and make a positive contribution towards the Postal Service's institutional costs. *Id.* at 2-3.

IV. COMMISSION ANALYSIS

The Commission has reviewed the Request, the contract, the supporting data filed under seal, and the Public Representative's comments.

Product list requirements. The Commission's statutory responsibilities when evaluating the Request include assigning Priority Mail Express Contract 18 to either the market dominant or competitive product list. See 39 U.S.C. § 3642(b)(1); 39 C.F.R. § 3020.34. Before adding a product to the competitive product list, the Commission must determine that the Postal Service does not exercise sufficient market power that it can effectively set the price of the product substantially above costs, raise prices significantly, decrease quality, or decrease output, without the risk of losing a significant level of business to other firms offering similar products. See 39 U.S.C. § 3642(b)(1). In addition, the Commission must consider the availability and nature of private sector enterprises engaged in delivering the product, the views of those who use the product,

⁴ Public Representative Comments on the Request of the United States Postal Service to Add Priority Mail Express Contract 18 to Competitive Product List, April 28, 2014.

and the likely impact on small business concerns. See 39 U.S.C. § 3642(b)(3); 39 C.F.R. §§ 3020.32(f), (g), and (h).

The Postal Service asserts that it provides postal services of the kind provided under the contract in a highly competitive market, that other shippers who provide similar services constrain its bargaining position, and that it can therefore neither raise prices nor decrease service, quality, or output without risking the loss of business to competitors. Request, Attachment D at 2. The Postal Service states that the contract partner supports the Request, that expedited shipping is widely available from private firms, and that the Postal Service is unaware of any small business concerns that could offer comparable services to the contract partner. *Id.* at 3.

The Commission finds that the Postal Service does not exercise sufficient market power that it can effectively set the price of the proposed product substantially above costs, raise prices significantly, decrease quality, or decrease output, without the risk of losing a significant level of business to other firms offering similar products. The availability of other private sector providers supports this conclusion. The contract partner supports the addition of the Priority Mail Express Contract 18 product to the competitive product list. Further, there is no evidence of an adverse impact on small businesses. For these reasons, having considered the relevant statutory and regulatory requirements, the comments filed, and the Postal Service's supporting justification, the Commission finds that Priority Mail Express Contract 18 is appropriately classified as competitive and is added to the competitive product list.

Cost considerations. Because the Commission finds Priority Mail Express Contract 18 is a competitive product, the Postal Service must also show that the contract covers its attributable costs, contributes to the Postal Service's institutional costs, and does not cause any market dominant products to subsidize competitive products. 39 U.S.C. § 3633(a); 39 C.F.R. §§ 3015.5 and 3015.7.

As part of its Request, the Postal Service submitted a certified statement that the contract complies with the requirements of 39 U.S.C. § 3633(a). Request,

Attachment E. In addition, the Postal Service filed supporting revenue and cost data showing that the contract is expected to cover its costs. Based on a review of the financial workpapers, the Commission finds that the rates during the first year of the contract should cover the contract's attributable costs. 39 U.S.C. § 3633(a)(2). Additionally, it finds that the contract should not result in competitive products being subsidized by market dominant products, in accordance with 39 U.S.C. § 3633(a)(1). It also finds the contract should have a positive effect on the contribution of competitive products to institutional costs, in furtherance of 39 U.S.C. § 3633(a)(3). Accordingly, a preliminary review of the contract indicates it is consistent with section 3633(a).

The contract contains a price adjustment provision that increases contract rates during subsequent contract years. Request, Attachment B at 2. The adjustment provision increases the likelihood that prices will cover attributable costs during subsequent contract years. The Commission will review the contract's cost coverage in the Commission's Annual Compliance Determination to ensure that rates continue to cover costs during subsequent years.

The Commission has identified a costing issue related to volume distribution where the Postal Service could improve the specificity of the cost model. The Postal Service's method of determining the "Partner Profile Adjusted" unit attributable cost by cost function is appropriate when the distribution of volume by billing determinant cell is roughly the same as the distribution of contract partner mail. However, the Commission has previously stated that:

When the Postal Service enters into a contract that has a volume distribution that is substantially different from the [Cost and Revenue Analysis] costs for the underlying product, the Postal Service should adjust its cost estimates of the contract partner's volumes by accounting for these differences in distribution, including presort level, or provide a rationale for why CRA average unit attributable costs are appropriate.⁵

⁵ Docket Nos. MC2014-14 and CP2014-23, Order Adding First-Class Package Service Contract 35 to the Competitive Product List, January 24, 2014, at 7-8 (Order No. 1975).

In this contract, partner volume is limited to selected rate categories and excludes all other categories of Priority Mail Express. The Postal Service provided an estimate of the contract partner's unit cost based on CRA average unit attributable costs. It did not provide a rationale for why the use of CRA average unit attributable costs are appropriate for this purpose.

This issue appears when calculating the unit transportation costs in this contract.⁶ In its financial workpapers, the Postal Service adjusts CRA unit Priority Mail Express transportation costs based on the difference between the average weight per piece underlying the CRA costs and the average weight per piece for the contract partner's mail. This approach can be improved by first developing the CRA-level unit transportation cost per piece for the selected rate categories that comprise the contract volume. Then the Postal Service should calculate the weight per piece for this new CRA-level grouping, compare this average weight per piece with the contract partner's mail weight per piece, and adjust the CRA-level cost for the new grouping accordingly. Because the Postal Service's workpapers contain weight and volume data by rate cell, it may be possible to determine the unit transportation costs of the selected rate categories that comprise the contract volume. This methodology would provide a more accurate estimate of unit attributable costs for both the contract and the Partner Profile Adjusted calculations.

Consistent with Order No. 1975, the appropriate calculation for the contract partner's transportation cost should be based on the transportation costs for the selected rate categories that comprise the contract volume. The Postal Service should consider differences in volume distribution between a contract partner and the CRA costs for the underlying product. It should adjust its cost estimates of the contract partner's volumes by accounting for these differences in distribution, including presort

⁶ Adjustment factors are not applied to mail processing, delivery, packaging, or other costs. Window service costs are completely excluded because the partner will not be using window service.

level. Otherwise, the Postal Service should provide a rationale for why CRA average unit attributable costs are appropriate.

Other considerations. By its terms, the contract becomes effective one business day following the day that the Commission issues all necessary regulatory approvals. Request, Attachment B at 2. The contract is scheduled to expire three years from the effective date, unless, among other things, either party terminates the contract with 30 days' written notice to the other party or it is renewed by written mutual agreement.⁷

The contract also contains a provision that allows the parties to extend the contract for two 90-day periods if a successor agreement is being prepared and the Commission is notified within 7 days of the contract expiring.⁸ During the extension periods, prices will be adjusted as described in the contract. Request, Attachment B at 3. The Commission finds the two potential 90-day extension periods are reasonable because: (1) prices are automatically adjusted in the extension period, making it likely that the contract will continue to cover its attributable costs; and (2) the extension(s) should assist the Postal Service's contract negotiations by providing additional flexibility.

If the instant contract is terminated prior to the scheduled expiration date, the Postal Service shall promptly notify the Commission.

Within 30 days after the instant contract terminates, the Postal Service shall file the annual (contract year) costs, volumes, and revenues disaggregated by weight and zone associated with the contract.

⁷ *Id.* Should both parties agree to renew the contract, any such renewal is required to follow the requirements of 39 U.S.C. § 3633 and the Commission's implementing regulations of 39 C.F.R. part 3015.

⁸ *Id.* at 2-3. As the Commission noted in Order No. 1773, the Postal Service clarified that substantially similar language in Priority Mail Contract 60 contemplates the Postal Service filing any notices of extension with the Commission *at least one week prior to* the expiration of the contract, as opposed to the instant contract's "within at least seven (7) days of the contract's expiration date." See Docket Nos. MC2013-54 and CP2013-70, Order No. 1773, Order Adding Priority Mail Contract 60 to the Competitive Product List, July 8, 2013, at 3; *see also* Docket Nos. MC2013-54 and CP2013-70, Response of the United States Postal Service to Chairman's Information Request No. 1, July 1, 2013, question 2.

In conclusion, the Commission approves Priority Mail Express Contract 18 as a new product. The revision to the competitive product list appears below the signature of this Order and is effective immediately.

V. ORDERING PARAGRAPHS

It is ordered:

1. Priority Mail Express Contract 18 (MC2014-25 and CP2014-48) is added to the competitive product list as a new product under Negotiated Service Agreements, Domestic. Revisions to the competitive product list and the Mail Classification Schedule appear below the signature of this Order and are effective immediately.
2. The Postal Service shall notify the Commission if the instant contract terminates prior to the scheduled expiration date as discussed in this Order.
3. Within 30 days after the instant contract terminates, the Postal Service shall file the annual (contract year) costs, volumes, and revenues disaggregated by weight and zone associated with the contract.
4. The Secretary shall arrange for publication in the *Federal Register* of an updated product list reflecting the change made in this Order.

By the Commission.

Shoshana M. Grove
Secretary

CHANGE IN PRODUCT LIST

The following material represents changes to the product list codified in Appendix A to 39 C.F.R. part 3020, subpart A—Mail Classification Schedule. These changes reflect the Commission’s order in Docket Nos. MC2014-25 and CP2014-48. The Commission uses two main conventions when making changes to the product list. New text is underlined. Deleted text is struck through.

Part B—Competitive Products **2000 Competitive Product List**

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Negotiated Service Agreements*

Domestic*

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Priority Mail Express Contract 18

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CHANGES TO THE MAIL CLASSIFICATION SCHEDULE

The following material represents a change to the Mail Classification Schedule. The Commission uses two main conventions when making changes to the Mail Classification Schedule. New text is underlined. Deleted text is struck through.

Part B—Competitive Product List **2000 Competitive Product List**

Negotiated Service Agreements*

Domestic*

Priority Mail Express Contract 18

2500 **Negotiated Service Agreements**

2505 **Domestic**

2505.3 **Priority Mail Express Contracts**

- Priority Mail Express Contract 18

Baseline Reference

Docket Nos. MC2014-25 and CP2014-48

PRC Order No. 2072, April 30, 2014

Included Agreements

CP2014-48, expires May 1, 2017
